

Unrelated trade or business; machine rental. A section 501(c)(3) organization's leasing of heavy machinery under long-term lease agreements requiring the lessee to provide insurance, pay the applicable taxes, and make and pay for most repairs, with the functions of securing leases and processing rental payments performed for the organization without compensation, is not excepted from the term 'unrelated trade or business' by reason of section 513(a)(1) of the Code.

Advice has been requested whether, under the circumstances described below, a machine rental business is excepted from the term 'unrelated trade or business' by virtue of the exception provided in section 513(a)(1) of the Internal Revenue Code of 1954, which applies to any trade or business in which substantially all the work is performed without compensation.

An organization that is exempt from Federal income tax under section 501(c)(3) of the Code owns various kinds of heavy machinery which it has acquired from time to time. It leases the machinery to others under lease agreements that require the lessee to provide insurance, pay any taxes, and make and pay for all repairs except those involving defects in the machine parts or workmanship. The lease periods range from five to eight years with options to renew. In the organization's experience, the lessees usually renew their leases until the machinery becomes obsolete. Thus, once the organization finds a lessee and arranges for a lease on a particular machine, the only remaining requirement is to receive, record, and deposit the rents. The work in connection with finding a lessee, negotiating a lease, and processing the rental payments is performed for the organization without compensation. The rental activity has been carried on by the organization continuously for many years. It provides additional funds for use in the organization's ongoing charitable program.

Section 513(a) of the Code provides that the term 'unrelated trade or business' means any trade or business the conduct of which is not substantially related to an organization's performance of its exempt purpose or function, aside from its need for income or funds or the use it makes of the profits derived. Section 513(a)(1) provides that the term does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.513-1(e) of the Income Tax Regulations provides an example of the kind of trade or business that is not included in the term 'unrelated trade or business' under section 513(a)(1) of the Code. The example is of an exempt orphanage operating a retail store and selling to the general public. Substantially all the work in carrying on the business is performed for the organization by volunteers without compensation.

The legislative history of section 513(a)(1) of the Code indicates with a similar example that Congress was thereby providing an exclusion from the definition of unrelated trade or business only for those unrelated business activities in which the performance of services is a material income-producing factor in carrying on the business and substantially all such services are performed without compensation. See H.R. Rep. No. 2319, 81st Cong., 2d Sess. (1950), 1950-2 C.B. 380, and S. Rep. No. 2375, 81st Cong., 2d Sess. (1950), 1950-2 C.B. 483.

The rental of personal property under arrangements similar to those described here has consistently been treated as the conduct of trade or business. See Rev. Rul. 60-206, 1960-1 C.B. 201, and Rev. Rul. 69-278, 1969-1 C.B. 148. However, the application of section 513(a)(1) of the Code was not an issue in either Revenue Ruling.

In this case, the only regularly recurring work in carrying on the leasing activity is the processing of the rental payments from the leases. Because the organization's experience has been that the same lessees keep the equipment on a long-term basis, only occasionally does the work involve acquiring machinery, finding lessees, and negotiating leases. All other obligations related to the machinery have been assumed by the lessees under the terms of their leases. Thus, there is no significant amount of labor regularly required or involved in the kind of business carried on by the organization. Although the work in carrying on the rental activity may be performed without compensation, the performance of services in this case is not a material income-producing factor in the business and, therefore, section 513(a)(1) of the Code does not apply.

Accordingly, the machine rental business described above is not excepted from the term 'unrelated trade or business' by virtue of the exception provided in section 513(a)(1) of the Code.